

Pike, Frederick B. *FDR's Good Neighbor Policy: Sixty Years of Generally Gentle Chaos*. Austin: University of Texas Press, 1995.

See also Volume 1: Roosevelt, Franklin D.; Roosevelt, Theodore; Wilson, Woodrow.

Government Budgets

The balance sheets of national, state, and local governments displaying the relationships between government spending and tax revenues in one year.

Government budgets have two elements: spending (G) and tax revenues (T). A budget can be balanced ($G = T$), in deficit ($G < T$), or in surplus ($G > T$). The summation of all past federal budget deficits and surpluses constitutes the national debt. Three views on federal government budgets (and debt) are "deficit hawk," "deficit dove," and "functional finance." Deficit hawks view government deficits as causing inflation and/or high interest rates. Many argue that public spending crowds out private spending, because any increase in government spending must be financed through either taxes or bond sales, both of which would decrease private consumption and/or investment. In addition, deficit hawks view the national debt as a financial burden on future generations. Thus, deficit hawks recommend a balanced budget (or a surplus) in every single year, and many support a constitutional amendment to require a balanced budget.

Deficit doves believe deficits can be useful when used appropriately and responsibly. The government can run deficits during recessions, they believe, but it should also run surpluses during economic booms so that the budget is balanced over the business cycle. Deficit doves also argue that many measurement and accounting problems are related to deficits and the debt. The most important issue they emphasize in this regard is that the federal government keeps no capital account to hold a surplus of funds. Deficit doves argue that deficit/gross domestic product (GDP) ratios and debt/GDP ratios are more important than the absolute size of the deficit or the debt. According to deficit doves, high interest rates cause bigger deficits (not vice versa) because interest payments on the debt increase as interest rates rise. They also argue that there is no financial burden on future generations because government spending is simultaneously creating assets for the future. Furthermore, deficit doves point out that unemployment generates bigger deficits because of its association with lower tax revenues and higher government spending on things like unemployment compensation.

The functional finance view suggests that both hawks and doves are wrong. In a modern (state) money system in which government is the monopoly issuer of fiat currency (useless currency that is accepted as a medium of exchange), the state does not need the public's money in order to spend. Taxes and bond sales do not finance government spending. The purpose of taxes (and the requirement that taxes be paid in government money) is to create a demand for the fiat money. Bond sales drain the excess reserves created by deficit spending to maintain short-term (overnight) interest rates. In the

functional finance view, the particular relation of G and T does not matter in and of itself; what matters are the effects of the budget stance. Deficit hawks treat the modern money system as though it were a gold standard, whereas deficit doves emphasize that the deficit is not really as big as it seems or that we can afford the deficit or the debt. According to the functional finance view, deficit and the debt are accounting information on the one hand and policy instruments on the other. Deficits can be too big, but they can also be too small, depending on the economic context. Debt is not a burden, because the monopoly issuer of the currency never has any problem settling an obligation denominated in that currency.

—Fadhel Kaboub and Mathew Forstater

References

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See also Volume 1: Budget Deficits and Surpluses.

Gramm-Rudman-Hollings, Balanced Budget, and Emergency Deficit Control Act (1985)

Failed effort to legislate a balanced budget in response to a conservative movement that strongly opposed increased government spending.

Before 1985, congressional majorities necessary to pass a balanced budget amendment to the Constitution were lacking. The Gramm-Rudman-Hollings Act (GRH) was second best for some "deficit hawks," who recommended a balanced budget or surplus in every year and felt the legislation would provide the president and Congress with an important incentive to come to budget agreements. GRH, named for its sponsors, Senators Phil Gramm (R-Texas), Warren Rudman (R-New Hampshire), and Ernest Hollings (D-South Carolina), mandated a timetable of reduced budget deficits beginning in 1985 and ending with a balanced federal budget in 1991. In 1987, that target date changed to 1993. In 1990, the Omnibus Budget Reconciliation Act repealed GRH.

GRH required automatic spending cuts divided equally between defense and nondefense spending should the president and Congress not agree on a budget that reached that year's target. Social Security expenditures, interest on the national debt, and some programs targeted at the poor remained exempted from those automatic cuts.

In the mid-1980s, the administration of Republican President Ronald Reagan accused Congress of being unable to control spending. Congressional Democrats blamed the ballooning deficit on a big tax cut in 1981 (which lowered taxes for those in the highest tax brackets and was designed to produce a trickle-down effect in the economy) and a defense buildup. The GRH compromise promised Democrats that